



State of Washington  
Joint Legislative Audit  
and Review Committee

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# Linked Deposit Program Sunset Review

## Report 99-7

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September 15, 1999

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The Joint Legislative Audit and Review Committee**

Established by Chapter 44.28 RCW, the Joint Legislative Audit and Review Committee (formerly the Legislative Budget Committee) provides oversight of state funded programs and activities. As a joint, bipartisan legislative committee, membership consists of eight senators and eight representatives equally divided between the two major political parties.

Under the direction of the Legislative Auditor, committee staff conduct performance audits, program evaluations, sunset reviews, and other types of policy and fiscal studies. Study reports typically focus on the efficiency and effectiveness of agency operations, impact of state programs, and compliance with legislative intent. As appropriate, recommendations to correct identified problem areas are included. The Legislative Auditor also has responsibility for facilitating implementation of effective performance measurement throughout state government.

The JLARC generally meets on a monthly basis during the interim between legislative sessions. It adopts study reports, recommends action to the legislature and the executive branch, sponsors legislation, and reviews the status of implementing recommendations.

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# TABLE OF CONTENTS

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<b>Chapter</b>		<b>Page</b>
	<b>Summary</b>	<b>i</b>
	<b>Recommendations</b>	<b>vii</b>
<b>1</b>	<b>Introduction</b>	<b>1</b>
	Mandate	1
	Program Background	1
	Scope, Objectives, and Audit Methodology	6
	Report Organization	6
<b>2</b>	<b>Compliance with Legislative Intent</b>	<b>9</b>
	Legislative Intent	9
	Programs in Other States	12
	Conclusions and Recommendation	14
<b>3</b>	<b>Economy, Efficiency, and Duplication</b>	<b>15</b>
	Program Costs	15
	Program Monitoring	17
	Programs in Other States	20
	Duplication	23
	Conclusions and Recommendation	23
<b>4</b>	<b>Program Results and Effectiveness</b>	<b>25</b>
	Impact of Rate Reduction	25
	Performance Measures	27
	Programs in Other States	29
	Conclusions and Recommendation	29

<b>Chapter</b>		<b>Page</b>
<b>5</b>	<b>Continuing Program Need</b>	<b>31</b>
	Assessment of Program Need	31
	Conclusions and Recommendation	33
<b>Appendices</b>		
<b>1</b>	<b>Scope and Objectives</b>	<b>35</b>
<b>2</b>	<b>Agency Responses</b>	<b>37</b>
<b>3</b>	<b>Audit Methodology and Limitations</b>	<b>47</b>
	Background Research and Stakeholder Input	47
	Cost Analysis	47
	Survey of Linked Deposit Loan Recipients	50
	Review of Linked Deposit Loans and Interviews with Lenders	50
	Survey of Other States	52
<b>4</b>	<b>Questionnaire for Survey of Linked Deposit Loan Recipients</b>	<b>55</b>
<b>5</b>	<b>Selected Bibliography</b>	<b>59</b>

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# LINKED DEPOSIT PROGRAM SUNSET REVIEW

## Summary

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### INTRODUCTION

This is a mandated sunset review of the Linked Deposit Program. The program is scheduled to terminate on June 30, 2000, as provided in RCW 43.131.381/382.

Washington’s Linked Deposit Program was created in 1993 by the Omnibus Minority and Women-Owned Businesses Assistance Act (ESHB 1493). The purpose of the program is to increase access to business capital for the state’s minority- and women-owned businesses.

### PROGRAM BACKGROUND

The Linked Deposit Program enables state-certified small businesses owned by minorities and women to obtain loans from participating private Washington banks at a reduced interest rate. The State Treasurer is authorized to use up to \$50 million of short-term state treasury surplus funds (RCW 43.86A.030) for the Linked Deposit Program.

The program funds (\$50 million) are used for purchasing certificates of deposit equaling the total amount of money loaned by private banks to certified small businesses owned by minorities and women. The interest earned by the state on these certificates of deposit is two percentage points (200 basis points) less than the current market rate. This forgone interest earning is then passed on to Linked Deposit loan recipients. They pay two percentage points below the current market rate on their loans at participating banks. Under the program, banks are not required to change their underwriting standards for borrowers. The

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**Enables  
qualified  
borrowers to  
receive  
reduced  
interest rate  
loans from  
private banks**

certificates of deposit are not at risk of losing any portion of the principal amount.

Three agencies are involved in implementing the program. Under the program’s authorizing statute (RCW 43.86A.060), the Office of the State Treasurer is responsible for establishing the program. The Department of Community, Trade and Economic Development (CTED), in consultation with the State Treasurer, is responsible for monitoring the program (RCW 43.63A.690).

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Certified minority and women’s business enterprises defined

The role of the Office of Minority and Women’s Business Enterprises (OMWBE) in the Linked Deposit Program is through its process of certification of small businesses owned by minorities and women. To be eligible for the state certification as a minority or women’s business enterprise, the applicant must be minority and/or female and have at least 51 percent of ownership in a small business and control the business. “Minority” means persons of color, including African-Americans, Hispanic/Latino Americans, Native Americans, and Asian/Pacific Islander Americans.

The program has enabled 230 certified minority and women’s business enterprises to obtain reduced interest rate loans. Currently, there are 20 banks that participate in the program. As of February 1999, a total of more than \$48 million of the \$50 million authorized for the program was committed in certificates of deposit in participating banks.

## COMPLIANCE WITH LEGISLATIVE INTENT

**Question:** *Have the Office of the State Treasurer, the Office of Minority and Women’s Business Enterprises, and the Department of Community, Trade and Economic Development complied with legislative intent in implementing the Linked Deposit Program?*

**Answer:** The program has been implemented according to the authorizing legislation. However, criteria for determining the extent to which Linked Deposit loan applicants lack access to capital are absent in the legislation. Thus, whether or not the program has met the legislative intent to remedy the problem of a

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Criteria for determining lack of access to capital absent

lack of access to capital for minority and women business enterprises is difficult to assess.

Furthermore, the program does not have a mechanism to ensure that a few businesses do not use a relatively large portion of program funds. So far this has not been an issue since the program has had sufficient funds to issue certificates of deposit for all qualified borrowers. However, the use of program funds is now reaching the ceiling of \$50 million. Therefore, now and in the future, it would be useful to have a limit on the maximum amount that can be borrowed by a business.

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No limits on the amount borrowed

## ECONOMY, EFFICIENCY, AND DUPLICATION

### **Audit Questions:**

- *How much does the program cost the state?*
- *Have the implementing agencies operated the Linked Deposit Program in an efficient and economical manner?*
- *What are key characteristics of similar programs in other states?*
- *Does the program unnecessarily duplicate other public or private efforts?*

**Answers:** The three agencies responsible for implementing the program do not incur significant administrative costs. According to officials at each of the three agencies, very small portions of existing agency resources are used to implement the program. The program does not receive funds for its administration.

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No significant administrative costs

The primary cost of the program is in forgone interest earnings on state funds. Participating banks pay two percentage points less than the market rate to the state on its short-term certificates of deposit. On the \$50 million earmarked for the program, this reduction amounts to \$1 million in forgone interest earnings.

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Primary cost is in forgone interest earnings on state deposits

However, we found that the cost of the interest rate reduction for Linked Deposit loan recipients is more than the loss of two percentage points in interest earnings. This is because such funds could have been invested in financial instruments yielding

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**Estimated  
program cost  
\$3.8 million:  
1994-99**

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higher returns if the funds were not dedicated to the Linked Deposit Program. Hence, for the \$50 million earmarked to be available for the program, forgone interest income amounts to \$1,225,000 per year (instead of \$1 million as thought generally). Since its inception (from June 1994 through February 1999), the program has cost the state an estimated total of \$3.8 million in forgone interest earnings.

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**Weak  
program  
controls and  
performance  
data**

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Lack of program monitoring has resulted in inaccuracies in the program's database, as well as in use of the program by businesses without proper certification through OMWBE. Similar programs in other states reported a range of monitoring activities. Program officials cite lack of resources and the need for program simplicity to increase participation as the reasons for weak program controls. However, adequate controls are needed to ensure compliance with legislative intent and program requirements.

We acknowledge that implementing elaborate controls can cost a significant amount of resources and can make the program burdensome for program participants. However, we think that Recommendations 2 and 3 discussed in this report can be implemented without incurring any significant additional costs or imposing unnecessary procedures on participants.

Finally, we did not find evidence to show that Washington's Linked Deposit Program is unnecessarily duplicative.

## **PROGRAM RESULTS AND EFFECTIVENESS**

### ***Audit Questions:***

- *What are the results of the Linked Deposit Program since its inception?*
- *To what extent has the program been effective in meeting legislative intent to remedy the stated problem of a lack of access to capital by minority and women's business enterprises?*

**Answers:** The program has enabled 230 borrowers to receive reduced interest rate loans. However, the Linked Deposit Program's effectiveness or impact cannot be measured because the program lacks performance indicators and relevant data. Performance information is largely anecdotal, which includes participants' views on the program's usefulness. Both loan recipients and banks generally commented favorably on the program.

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230  
borrowers  
have  
benefited

## CONTINUING PROGRAM NEED

### **Audit Questions:**

- *Have the agencies responsible for implementing the Linked Deposit Program demonstrated the need to continue the program?*
- *Specifically, has the need identified at the inception of the Linked Deposit Program—that is, lack of access to capital among minority- and women-owned businesses—been sufficiently demonstrated to continue to exist?*
- *If the program is continued, are statutory modifications needed?*

**Answers:** The agencies responsible for implementing the program have presented qualitative information to demonstrate the need to continue the program. We did not find statistical evidence that identifies lack of access to capital by businesses owned by minorities and women. Furthermore, due to lack of sufficient performance data, it is difficult to comment on the Linked Deposit Program's overall effectiveness.

Based on the comments received from Linked Deposit loan recipients and lenders, as well as our review of loan records, we can say that the program has made a positive difference for a number of program participants. If the program is continued, the report recommends statutory as well as other modifications relating to program controls and performance measures.

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Program  
changes  
needed

## AGENCY RESPONSE

We have shared the report with the Department of Community, Trade and Economic Development (CTED), the Office of the State Treasurer, the Office of Minority and Women's Business Enterprises (OMWBE), and the Office of Financial Management (OFM), and provided them an opportunity to submit written comments on the report's four recommendations. The Office of the State Treasurer concurs with each of the recommendations. CTED, OMWBE, and OFM partially concur with each of the recommendations. Their written responses are attached as Appendix 2.

## ACKNOWLEDGMENTS

We appreciate the assistance and cooperation extended to us by officials and staff of the Office of the State Treasurer, the Department of Community, Trade and Economic Development, and the Office of Minority and Women's Business Enterprises. This study was conducted by JLARC staff member Rakesh Mohan. The Pacific Consulting Group was retained to collect and analyze information provided by Washington banks for the study. Tom Sykes served as the project supervisor.

Thomas M. Sykes  
Legislative Auditor

On September 15, 1999, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

Senator Georgia Gardner  
Chair

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# RECOMMENDATIONS

## Summary

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### ***Recommendation 1***

To maximize the use of the Linked Deposit Program by a larger number of targeted business owners, we recommend that the legislature consider putting a ceiling on the maximum amount that can be borrowed by a Linked Deposit loan applicant.

Legislation Required:	Yes
Fiscal Impact:	None
Completion Date:	June 2000

### ***Recommendation 2***

To ensure compliance with program requirements, the Office of the State Treasurer, the Department of Community, Trade and Economic Development, and the Office of Minority and Women's Business Enterprises should develop and implement limited procedures for monitoring the Linked Deposit Program. This should include the following:

- Obtain from participating banks information such as minority and women's business enterprise certification status, loan amount, interest rate, loan term, purpose of the loan, and business name and address for each Linked Deposit loan recipient before the State Treasurer purchases certificates of deposit for such loans.

- Ensure that non-certified minority and women’s business enterprises do not obtain or maintain the reduced interest rate loans under the program.

Legislation Required:	None
Fiscal Impact:	Minimal
Completion Date:	January 2000

***Recommendation 3***

The Department of Community, Trade and Economic Development and the Office of Minority and Women’s Business Enterprises should establish modest, cost-effective, yet meaningful, indicators to measure program performance.

Legislation Required:	None
Fiscal Impact:	Minimal
Completion Date:	January 2000

***Recommendation 4***

In the absence of sufficient statistical evidence demonstrating the program’s continuing need, the legislature should consider modifications discussed in Recommendations 1 through 3 if it decides to continue the Linked Deposit Program.

Legislation Required:	Yes
Fiscal Impact:	Minimal
Completion Date:	June 2000

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# INTRODUCTION

## Chapter One

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### MANDATE

This is a mandated sunset review of the Linked Deposit Program. The program is scheduled to terminate on June 30, 2000, as provided in RCW 43.131.381/382.

Washington's Linked Deposit Program was created in 1993 by the Omnibus Minority and Women-Owned Businesses Assistance Act (ESHB 1493). The purpose of the program is to increase access to business capital for the state's minority- and women-owned businesses. Under the program, certified minority- and women-owned small businesses can obtain reduced interest rate loans from participating private financial institutions.

### PROGRAM BACKGROUND

The Linked Deposit Program enables state-certified small businesses owned by minorities and women to obtain loans from participating private Washington banks at a reduced interest rate. The State Treasurer is authorized to use up to \$50 million of short-term state treasury surplus funds (RCW 43.86A.030) for the Linked Deposit Program.

The program funds (\$50 million) are used for purchasing certificates of deposit equaling the total amount of money loaned by private banks to certified small businesses owned by minorities and women. The interest earned by the state on these certificates of deposit is two percentage points (200 basis points) less than the current market rate. This forgone interest earning is then passed on to Linked Deposit loan recipients. They pay two percentage points below the current market rate on their loans at

participating banks. The certificates of deposit are not at any risk.

**Three agencies are involved in implementing the program.** Under the program's authorizing statute (RCW 43.86A.060), the Office of the State Treasurer is responsible for establishing the program. The Department of Community, Trade and Economic Development (CTED), in consultation with the State Treasurer, is responsible for monitoring the program (RCW 43.63A.690). CTED is also responsible for providing technical assistance and loan packaging services that enable minority- and women-owned business enterprises to obtain financing under the Linked Deposit Program.

The role of the Office of Minority and Women's Business Enterprises (OMWBE) in the Linked Deposit Program is through its process of certification of small businesses owned by minorities and women. To be eligible for the state certification as a minority or women business enterprise, the applicant must be minority and/or female and have at least 51 percent of ownership in a small business and control the business. "Minority" means persons of color, including African-Americans, Hispanic/Latino Americans, Native Americans, and Asian/Pacific Islander Americans.

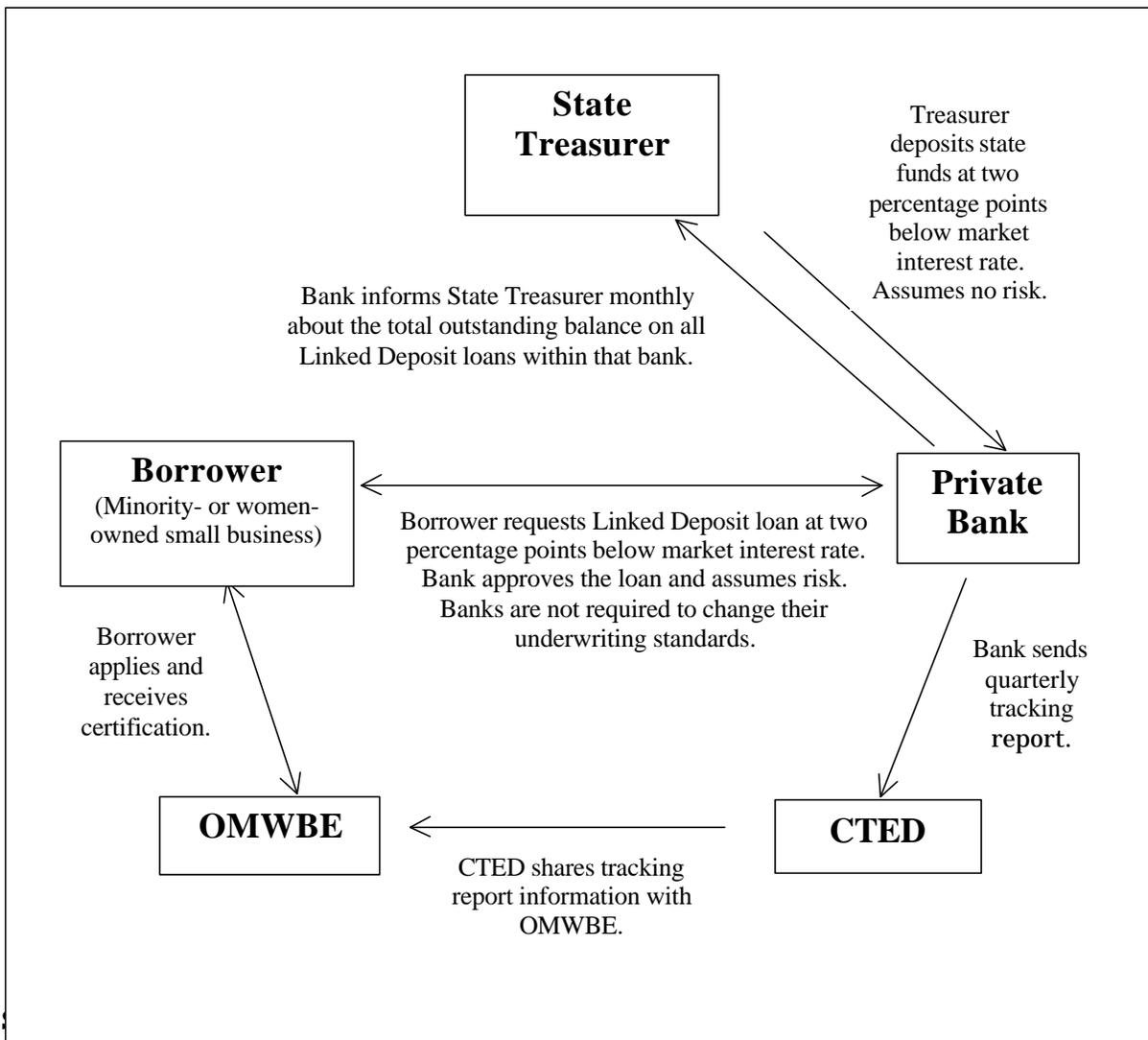
**Flow of Linked Deposit Program activities.** As shown in Exhibit 1, a certified minority or women's business enterprise applies for a reduced interest rate Linked Deposit loan at a participating bank. The program does not require banks to change their underwriting standards. The actual rate paid by the borrower varies depending on the bank, type of business, loan terms, and associated risk. The bank may write a longer length loan, but the lower interest rate applies for only up to five years. The reduced interest rate applies to new loans, refinancing of existing loans, or credit lines. There are no limits on the amount that can be borrowed or number of times a borrower can participate in the program.

If the loan is approved, the bank will inform the Office of the State Treasurer about the loan amount. The Treasurer's Office will purchase a certificate of deposit for an equal amount that is being loaned to the borrower at that bank. The Treasurer's Office

sets the interest rate for the certificate using the bond equivalent yield of the current one-year Treasury Bill, plus 50 basis points, minus the 200 basis point rate differential. This rate is adjusted monthly. The amount of the certificate of deposit is adjusted monthly to reflect the changes in the principal on the Linked Deposit loan during the preceding month. All transactions with the Treasurer's Office are done on an aggregate basis (that is, combined outstanding balances of all Linked Deposit loans with the bank).

On a quarterly basis, the bank informs CTED about its Linked Deposit loans. The bank does this by sending a tracking report for each borrower, which contains the borrower's name and business name, loan amount, OMWBE certification number, and loan approval date. CTED shares the information with OMWBE. Both CTED and OMWBE assist borrowers and banks if they have questions about the program or the certification process.

**Exhibit 1  
Flow of Linked Deposit Program Activities**



Source: Prepared by JLARC staff.

**Program Participation.** Based on the information available from CTED as of March 1999, a total of 230 businesses have participated in the program since its inception. The total amount that has been borrowed under the program is \$50,819,657.<sup>1</sup> Loans granted through the Linked Deposit Program have

<sup>1</sup> This is the cumulative amount that has been borrowed. However, according to State Treasurer's records, the outstanding balance used by the program as of February 1999 is \$48,158,443. The outstanding balance cannot exceed the \$50 million statutory limit for the program.

averaged \$220,955, with a range between \$5,000 and \$2.3 million. As can be seen in Exhibit 2, U.S. Bank has the largest share of Linked Deposit loans followed by Key Bank and Interwest. Approximately three-fourths of all loans (both in number and amount) are with these three banks.

**Exhibit 2**  
**Linked Deposit Loan Distribution Among Banks**

<b>Bank<sup>2</sup></b>	<b>Original Loan Amount</b>	<b>Percent of Total</b>	<b>Number of Loans</b>	<b>Percent of Total</b>
U.S. Bank	\$24,727,183	48.7%	100	43.5%
Key Bank	7,497,146	14.8%	43	18.7%
Interwest	5,247,728	10.3%	32	13.9%
First Mutual Bank	2,911,000	5.7%	*	*
Cowlitz Bank	2,260,731	4.4%	*	*
Commerce Bank of Washington	1,989,995	3.9%	10	4.3%
Washington Trust Bank	1,959,830	3.9%	8	3.5%
Sterling Savings Association	1,110,000	2.2%	*	*
Whidbey Island Bank	1,034,058	2.0%	*	*
Seattle First National Bank	632,480	1.2%	11	4.8%
Towne Bank	510,000	1.0%	*	*
Pullman, Bank of	226,860	0.4%	*	*
Frontier Bank	209,929	0.4%	*	*
Commercial Bank of Everett	183,236	0.4%	*	*
Wheatland Bank	127,500	0.3%	*	*
Harbor Bank	86,631	0.2%	*	*
First Heritage Bank	60,000	0.1%	*	*
Skagit State Bank	45,350	0.1%	*	*
<b>Grand Total</b>	<b>\$50,819,657</b>	<b>100.0%</b>	<b>230</b>	<b>100.0%</b>

**Source:** Prepared by JLARC staff and consultant, using information provided by CTED.

\* To maintain confidentiality of individual loans, we have not disclosed the number of loans in a bank if the number is five or less.

<sup>2</sup> CTED database shows that a total of 18 banks have participated in the program. However, documents obtained from the Office of the State Treasurer show that four other banks—Islanders Bank, Peoples Bank, Viking Community, and Wells Fargo—have also participated in the program through February 1999.

## SCOPE, OBJECTIVES, AND AUDIT METHODOLOGY

We followed the general sunset criteria (RCW 43.131.070) in conducting this review. The criteria place the burden of proof on agencies to demonstrate the extent to which they have complied with legislative intent, effectively provided needed services, operated the program in an efficient and economical manner, and not unnecessarily duplicated efforts of other public agencies or the private sector. In addition, the program under review needs to show its continuing need.

We asked program officials to provide us with information that directly answers the study objectives that are based on the sunset criteria. See Scope and Objectives in Appendix 1. A detailed discussion of audit methodology and limitations is contained in Appendix 3.

## REPORT ORGANIZATION

The remainder of this report is organized as follows:

- **Chapter Two** discusses the program's compliance with legislative intent. This chapter also describes how similar programs in other states limit the use of such programs to targeted populations.
- **Chapter Three** assesses the program's cost, operational efficiency, and management controls. It also discusses the issue of duplication of other public and private efforts. Key characteristics relating to program operations of similar linked deposit programs in other states are discussed in this chapter.
- **Chapter Four** describes program results and comments on the program's overall effectiveness. Performance measures used by similar linked deposit programs in other states are discussed in this chapter.
- **Chapter Five** assesses whether there is a continuing need for the program.
- **Appendix 1** discusses the audit scope and objectives.

- **Appendix 2** contains agency responses to the report.
- **Appendix 3** details the audit methodology and limitations.
- **Appendix 4** contains a copy of the questionnaire sent to Linked Deposit loan recipients.
- **Appendix 5** lists the selected bibliography used in this study.

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# COMPLIANCE WITH LEGISLATIVE INTENT

## Chapter Two

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**Audit Question:**

*Have the Office of the State Treasurer, the Office of Minority and Women's Business Enterprises, and the Department of Community, Trade and Economic Development complied with legislative intent in implementing the Linked Deposit Program?*

**Answer:** *The program has been implemented according to the authorizing legislation. However, criteria for determining the extent to which Linked Deposit loan applicants lack access to capital are absent in the legislation. Thus, whether or not the program has met the legislative intent to remedy the problem of a lack of access to capital for minority and women's business enterprises is difficult to assess. Furthermore, the program does not have a mechanism to ensure that a few businesses do not use a relatively large portion of program funds.*

## LEGISLATIVE INTENT

The program's legislative intent is defined in the authorizing legislation (RCW 43.86A.060):

It is the intent of the legislature to remedy the problem of a lack of access to capital by minority and women's business enterprises, and other small businesses by authorizing the state treasurer to operate a program that links state deposits to business loans by financial institutions to minority and women's business enterprises.

## No Criteria for Assessing Whether Applicants Lack Access to Capital

The program has been implemented according to the authorizing legislation. However, the legislation does not specify criteria for assessing whether or not a Linked Deposit loan applicant lacks access to capital. The legislation, which is broad, says that:

The legislature finds that minority and women's business enterprises have been historically excluded from access to capital in the marketplace. The lack of capital has been a major barrier to the development and expansion of business by various minority groups and women. There has been a significant amount of attention on the capital needs of minority and women's business enterprises.

Currently, the only statutory requirement to qualify for a Linked Deposit loan is that applicants should be certified minority or women's business enterprises, which are considered small businesses.<sup>1</sup> The certification process as implemented by the Office of Minority and Women's Business Enterprises (OMWBE) has no mechanism for monitoring and assessing the specific circumstances where individual applicants have been denied or had limited financing opportunities. Consequently, a certified minority- or women-owned business can qualify for the reduced interest rate loan regardless of the financial status of that individual business owner.

Absent such criteria, the program does not have data to show if it is benefiting those who actually lack access to capital. Depending

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<sup>1</sup> Chapter 326-20 of the Washington Administrative Code contains detailed criteria for certification, which include the following: (1) The business must be owned at least 51 percent by a minority or female, and (2) The business must be a "small business concern," not exceeding the applicable size limits. During the certification and re-certification process, OMWBE uses, as guidance, the U.S. Small Business Administration size standards set forth in Title 13 of the Code of Federal Regulations, Part 121, to determine whether a firm is a "small business concern." The size standard varies, depending on the industry involved, and is based either on gross receipts (averaged over the last three years), or number of employees. The largest allowable number of employees is 1,500. In no case, can the gross receipts exceed \$25 million.

on the purpose of the program, one of the following two options could be considered:

1. Continue to allow all certified minority and women's business enterprises to apply for Linked Deposit loans.
2. Develop criteria for assessing whether a Linked Deposit loan applicant lacks access to capital as well as estimate costs for administering such criteria. Based on this information, it could then be decided if the program should be targeted to those who have demonstrated a lack of access to capital.

### **No Upper Limit for Loan Amount**

Neither state law nor program rules specify an upper limit of the amount that can be borrowed under the Linked Deposit Program. This can result in limiting the program benefits to fewer minority- and women-owned businesses, or potentially to those less in need of subsidized access. So far this has not been an issue because program funds were always available. However, the lack of an upper limit on the amount borrowed can have an impact in the future since more than \$48 million of the total \$50 million in program funds were committed for existing loans as of February 1999.

According to the Treasurer's Office, as of July 15, 1999, seven banks have requested a total of nearly \$3.5 million to be reserved for their Linked Deposit customers. These customers will not be able to receive Linked Deposit loans until some of the existing Linked Deposit loans are paid back.

As shown in Exhibit 3, nearly 22 percent of the funds were used by 3 percent of the borrowers. The largest loan was for approximately \$2.3 million. On the other hand, only about 12 percent of the funds were used by 53 percent of the borrowers. The smallest loan amount was \$5,000.

**Exhibit 3**  
**Linked Deposit Loan Distribution**

<b>Range of Loan Amounts</b> <b>(\$ in thousands)</b>	<b>Borrowers</b>		<b>Total Borrowed</b>	
	<b>Number</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
\$0 - 50	67	29.1%	\$2,113,616	4.2%
51 - 100	55	23.9%	4,117,636	8.1%
101 - 200	40	17.4%	6,269,576	12.3%
201 - 400	32	13.9%	9,279,352	18.3%
401 - 600	17	7.4%	8,650,918	17.0%
601 - 1,000	12	5.2%	9,425,122	18.5%
1,001 - 1,500	4	1.7%	4,922,087	9.7%
1,501 - 2,300	3	1.3%	6,041,350	11.9%
<b>Totals</b>	<b>230</b>	<b>100.0%</b>	<b>\$ 50,819,657</b>	<b>100.0%</b>

**Source:** Prepared by JLARC staff and consultant, using data provided by CTED.

## PROGRAMS IN OTHER STATES

We identified 14 states that have programs similar to Washington's Linked Deposit Program. These programs focus on small businesses in general and/or small businesses owned by minorities and women. Some of these states have additional target populations that qualify for linked deposit loans.

Of the states surveyed, we found three states—New York, Texas, and Wisconsin—that target small businesses owned by minorities and women. Though Missouri does not target such businesses, it specifically markets the program to them.

### Other States Restrict the Loan Amount

All 14 states restrict the maximum amount that can be borrowed under their linked deposit programs as shown in Exhibit 4. Generally, the maximum loan amount varied from \$100,000 to \$500,000 and the loan term varied from 1 to 5 years.

**Exhibit 4**  
**Maximum Linked Deposit Loan Amounts in Other States**

State	Key Restrictions on Loan Amount and Terms
Alabama	<ul style="list-style-type: none"> <li>• Maximum loan amount \$500,000 for the small business program (depends on potential job creation/retention)</li> <li>• Loan term up to 2 years</li> <li>• Use the program one time</li> </ul>
Illinois	<ul style="list-style-type: none"> <li>• Loan amount depends on potential job creation</li> <li>• Loan term 1 – 5 years</li> </ul>
Iowa	<ul style="list-style-type: none"> <li>• Maximum loan amount \$100,000</li> <li>• Loan term 1 year (can be renewed for 8 additional terms)</li> <li>• Proceeds may not be used to speculate in real estate or for real estate investments</li> </ul>
Kentucky	<ul style="list-style-type: none"> <li>• Maximum loan amount \$100,000</li> <li>• Loan term up to 7 years</li> </ul>
Louisiana	<ul style="list-style-type: none"> <li>• Maximum loan amount \$200,000</li> <li>• Loan term up to 5 years</li> </ul>
Maine	<ul style="list-style-type: none"> <li>• Maximum loan amount \$200,000 per year (depends on potential job creation/retention)</li> <li>• Loan can be renewed for another year</li> </ul>
Maryland	<ul style="list-style-type: none"> <li>• Maximum loan amount \$500,000</li> <li>• Loan term at least 5 years</li> </ul>
Missouri	<ul style="list-style-type: none"> <li>• Maximum loan amount \$100,000 (can be renewed for up to 5 years)</li> </ul>
New York	<ul style="list-style-type: none"> <li>• Maximum loan amount \$1 million</li> <li>• Loan term 2 years</li> </ul>
Ohio	<ul style="list-style-type: none"> <li>• Maximum loan amount \$2 million (depends on potential job creation)</li> <li>• Loan term up to 2 years</li> </ul>
Oklahoma	<ul style="list-style-type: none"> <li>• Maximum loan amount \$1 million</li> <li>• Loan term 2 years (can be renewed for 3 additional terms)</li> </ul>
Pennsylvania	<ul style="list-style-type: none"> <li>• Maximum loan amount \$150,000</li> <li>• Loan term depends on the borrower's ability to pay and the use of the loan proceeds</li> </ul>
Texas	<ul style="list-style-type: none"> <li>• Loan amount from \$10,000 to \$250,000</li> <li>• Loan term usually the useful life of assets being financed</li> </ul>
Wisconsin	<ul style="list-style-type: none"> <li>• Loan amount from \$10,000 to \$99,000</li> <li>• Loan term not specified</li> </ul>

**Source:** Prepared by JLARC staff, using information obtained from other states.

## CONCLUSIONS AND RECOMMENDATION

The program has been implemented according to the authorizing legislation. However, criteria for determining the extent to which Linked Deposit loan applicants lack access to capital are absent. Thus, whether or not the program has met the legislative intent to remedy the problem of a lack of access to capital for minority and women's business enterprises is difficult to assess. Furthermore, the program does not have a mechanism to ensure that a few businesses do not use a relatively large portion of program funds.

### ***Recommendation 1***

*To maximize the use of the Linked Deposit Program by a larger number of targeted business owners, we recommend that the legislature consider putting a ceiling on the maximum amount that can be borrowed by a Linked Deposit loan applicant.*

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# ECONOMY, EFFICIENCY, AND DUPLICATION

## Chapter Three

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### **Audit Questions:**

- *How much does the program cost the state?*
- *Have the implementing agencies operated the Linked Deposit Program in an efficient and economical manner?*
- *What are key characteristics of similar programs in other states?*
- *Does the program unnecessarily duplicate other public or private efforts?*

**Answers:** *The three agencies responsible for implementing the program do not incur significant administrative costs. The program does not receive funds for its administration. However, the cost of the interest rate reduction for Linked Deposit loan recipients is more than the loss of two percentage points in interest earnings on short-term state deposits. The program lacks monitoring, which is a necessary management component for ensuring compliance, efficiency, and effectiveness. Similar programs in other states reported a range of monitoring activities. Finally, the program does not unnecessarily duplicate other public or private efforts.*

## PROGRAM COSTS

There are two cost components: (1) the cost of administering the program and (2) the cost of the interest rate reduction offered to Linked Deposit loan recipients.

## No Significant Administrative Costs

The three state agencies responsible for implementing the Linked Deposit Program do not incur significant administrative costs and have not received any state or other funds for administering the program.

According to officials at each of the three agencies, they use a very small portion of existing agency resources to implement the program. Agency officials did not have information that could be used to quantify the use of existing resources. For example, OMWBE is responsible for certifying all provisions of small businesses owned by minorities and women in Washington, regardless of the Linked Deposit Program. CTED is responsible for providing technical assistance to small businesses, and the State Treasurer has the fiduciary responsibility for managing state funds.

## Cost of Interest Rate Reduction

The primary cost of the program is in forgone interest earnings on state funds. The state deposits its funds for Linked Deposit loans in participating lending institutions at interest rates that are two percentage points (200 basis points) below the market rate. On the \$50 million earmarked for the program, this reduction amounts to \$1 million in forgone interest earnings.

However, the actual loss of interest is more than these two percentage points. This is because such funds could have been invested in other eligible financial instruments (as specified in state law) yielding higher returns if the funds were not dedicated to the Linked Deposit Program.

According to officials of the State Treasurer, if the funds were not dedicated for the Linked Deposit Program, the funds would be invested in financial instruments that would earn about 2.45 percentage points more. Hence, for the \$50 million, earmarked to be available to generate interest for the Linked Deposit Program, forgone interest income amounts to \$1,225,000 per year (instead of \$1 million as thought generally).

Since its inception (from June 1994 through February 1999), the program has cost the state an estimated total of \$3,806,138 in lost interest earnings. For a discussion of the methodology for cost calculations, see Appendix 3.

## PROGRAM MONITORING

Program monitoring is a key management function. Lack of program monitoring could have fiscal and programmatic consequences, such as misuse or inefficient use of state funds, non-compliance with legislative requirements, or ineffective program. Examples of monitoring activities would include maintaining accurate information about program participants and having procedures that would minimize participation of ineligible people in the program. We reviewed the Linked Deposit Program's policies, procedures, and practices to assess whether it has adequate controls and is monitored adequately by the agencies responsible for its implementation.

### Policy and Procedures Need Improvements

The state does not have accurate, verifiable information (such as amounts of loans and their interest rates) about each Linked Deposit loan. The Office of the State Treasurer receives monthly notifications of the aggregate amount lent under the Linked Deposit Program from each participating bank. The purpose of these reports is to inform the Treasurer's Office about the new amounts for the next month's certificates of deposit.

The Department of Community, Trade and Economic Development (CTED) receives a tracking report for each borrower. The tracking report contains identifying information about the borrower and the lender, loan amount, minority and women's business enterprise certification number, and date of loan approval. The report, however, does not list the reduced interest rate offered by the bank.

The state does not have procedures to prevent a prospective borrower, who has not been certified or who has been decertified by the Office of Minority and Women's Business Enterprises (OMWBE), from obtaining a Linked Deposit loan. Reasons for decertification include change in ownership and loss of contact with

the business. We found four cases<sup>1</sup> where the Linked Deposit loan was approved to decertified borrowers.

In addition, the state does not have procedures to identify Linked Deposit borrowers who become decertified after loan approval. It is not clear to program officials at the three agencies whether such a borrower continues to remain eligible for a reduced rate loan. The extent of this problem could not be established.

The state does not verify if the borrower has in fact received a 200 basis points discount on the Linked Deposit loan. In one case, we found that one loan recipient did not get the reduced interest rate at the time of the loan approval. However, when the loan recipient called the bank after receiving our questionnaire, the bank adjusted the interest rate. In a second case, the borrower never received the reduced interest rate.

Banks send tracking reports on a quarterly basis, not necessarily when the loan was activated. As a result, CTED may not know anything about the loan for three months. Furthermore, the tracking report reflects that the loan was approved by the bank. From this, one cannot always assume that the loan actually materialized.

CTED does not usually verify the information contained in the tracking report with any of the parties involved—State Treasurer, OMWBE, the lending bank, or the borrower. Hence, the program information, which is based on tracking reports received by CTED, is only an estimate.

If a bank has a question about a loan applicant's OMWBE certification, the bank will contact either CTED or OMWBE. In those cases, the program officials assist the bank and the loan applicant.

Agency officials acknowledged the weakness in program controls and cited two reasons for this weakness: (1) None of the three agencies responsible for implementing the program receive any state funds for the program, and (2) Program officials want to

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<sup>1</sup> We reviewed a list of 213 Linked Deposit loan recipients as of December 1998.

keep the program requirements simple in order to make it attractive to both lenders and borrowers.

## Actual Interest Rate Reduction

Because interest rates charged varied with perceived risk, loan term and other factors determining whether the borrower received a reduced interest rate requires judgment. However, in almost all cases (reviewed 15 loans), it was evident that borrowers were paying a reduced rate. In addition, it appeared reasonable to assume that the amount of the reduction equaled 2 percent.

Generally, loans were priced on a “variable” basis whereby the rate on the loan changed with index changes. In almost all cases, interest rates charged were based on each bank’s normal markup to a base rate, which was then reduced by a two-percentage point reduction called for under the program. The most common index used was “prime” as quoted in the Wall Street Journal. Some banks used the one-year Treasury Constant Maturity (TCM) rate as a base index, particularly for term loans. One bank actually established an index based on the rate paid to the state for the related certificate of deposit.

The manner in which the note and loan agreements were written to reflect the program varied. Some banks wrote the note at the normal rate with a separate loan agreement or letter providing for rate reduction under the program. Other banks include mention of the program in the note. In almost all cases reviewed, the note or loan agreement provided for an increase in rate in the event the borrower is no longer covered by the program.

There are two options that could be considered for ensuring that participating banks are in fact offering a two-percentage point reduction in interest rates to Linked Deposit loan recipients:

1. A limit could be set on the interest rates charged to Linked Deposit borrowers by participating banks. Similar linked deposit programs in other states offer examples of such limits as discussed in the next section (Exhibit 5).

2. Program officials could periodically review a sample of Linked Deposit loan files to assess whether borrowers actually received rate reductions of two-percentage points.

The benefits of implementing these options should be weighed against the costs involved in doing so. Both options will impose some regulatory burden on the participating banks and will require resources for monitoring compliance.

## PROGRAMS IN OTHER STATES

### Other States Specify Interest Rates for Borrowers

We reviewed information for 14 states with efforts similar to Washington's Linked Deposit Program. Generally, the rate reduction for linked deposit loans ranged from 1 to 4 percent as reported by the surveyed states. Arrangements between the state and the lender vary from state to state. As shown in Exhibit 5, eight of the 14 states specify the interest rates lenders can charge to the borrowers. A key advantage of specifying the interest rate is to ensure that borrowers are in fact being given reduced interest rate loans.

#### **Exhibit 5 Specific Interest Rates for Borrowers in Other States**

<b>State</b>	<b>Interest Rates Charged to Borrowers</b>
Illinois	Up to 300 basis points above what the bank pays to the state (Rate bank pays to the state = Two-year Treasury Rate x 70%)
Iowa	4% above what the bank pays to the state
Kentucky	Wall Street Journal Rate minus 1%
Missouri	Prime minus 94 basis points
Oklahoma	3% reduction (but not more than 5.5% above the rates set by the treasurer)
Pennsylvania	Cannot exceed 2.25% over prime (for loans of less than seven years) and 2.75% over prime (for loans of seven years or longer)
Texas	Treasury Note Rate plus up to 4%
Wisconsin	Cannot exceed Prime minus 1%

**Source:** Prepared by JLARC staff using information obtained from other states.

## Other States Report a Range of Monitoring Activities

None of the 14 states surveyed assume any risk that is associated with Linked Deposit loans. Yet, these states report various monitoring activities for ensuring that their programs comply with applicable laws and regulations and are implemented in an effective and efficient manner. As shown in Exhibit 6, these activities range from randomly auditing loan records to requiring borrowers to submit compliance reports.

### **Exhibit 6 Key Monitoring Activities of Linked Deposit Programs in Other States**

<p><b>Alabama</b></p> <ul style="list-style-type: none"> <li>• Send statements of account to lenders on a monthly and quarterly basis.</li> <li>• Send monitoring letters to borrowers at maturity.</li> </ul>
<p><b>Illinois</b></p> <ul style="list-style-type: none"> <li>• Conduct transactions with lending institutions for each individual linked deposit loan.</li> <li>• Require borrowers to submit a compliance report after two years for long-term loans.</li> </ul>
<p><b>Iowa</b></p> <ul style="list-style-type: none"> <li>• Lenders monitor businesses and let the program know if any are closed, being sold, etc.</li> <li>• Effective July 2000, every 3 years, borrowers will report to the program their updated financial and other business information.</li> </ul>
<p><b>Kentucky</b></p> <ul style="list-style-type: none"> <li>• Review loans to ensure compliance with the statute.</li> <li>• Receive annual statements from participating banks regarding principal payments and remaining balance.</li> </ul>
<p><b>Louisiana</b></p> <ul style="list-style-type: none"> <li>• Review loan application to assess qualifications for the program and compare applicant's cash flow to credit needs.</li> <li>• Process each loan separately.</li> </ul>
<p><b>Maine</b></p> <ul style="list-style-type: none"> <li>• Borrowers complete a new application for second year participation.</li> <li>• Reserve the right to audit bank records.</li> </ul>

<p><b>Maryland</b></p> <ul style="list-style-type: none"> <li>• Monitors the certificate of deposit earnings through periodic interest statements from the lender.</li> </ul>
<p><b>Missouri</b></p> <ul style="list-style-type: none"> <li>• Require a data summary at the end of deposit, which shows that the bank lent the money at the interest rate that was approved by the program and the amount of the loan matches the deposit.</li> <li>• Conducts random audits.</li> </ul>
<p><b>New York</b></p> <ul style="list-style-type: none"> <li>• Approve projects, identify depositors, monitor approved projects for deposits made, and monitor projects for renewal and maturity of certificates of deposit. Each deposit is linked to a specific loan.</li> <li>• Send an annual verification request to lenders to verify the current loan balances and interest rates on certificates of deposit.</li> <li>• Require borrowers to complete a questionnaire at the end of two-year participation.</li> </ul>
<p><b>Ohio</b></p> <ul style="list-style-type: none"> <li>• Have access to loan records at the bank.</li> <li>• Send progress questionnaire.</li> </ul>
<p><b>Oklahoma</b></p> <ul style="list-style-type: none"> <li>• Verify that the borrower is in good standing with the state tax commission and with the state employment security commission.</li> <li>• Compare reported job numbers by the applicant with the state employment security commission.</li> <li>• Require lenders and borrowers to separately report the interest rate that is being charged to the borrower.</li> <li>• Statutes allow for an audit provision of the lending institutions.</li> </ul>
<p><b>Pennsylvania</b></p> <ul style="list-style-type: none"> <li>• Require banks to certify the loan amount, purpose, and date, as well as the borrower's name within 12 months of receiving state deposits.</li> </ul>
<p><b>Texas</b></p> <ul style="list-style-type: none"> <li>• Require lenders to submit quarterly reports that detail the amount paid by the borrower, the interest on the state's deposit, and the outstanding balance of the loan.</li> <li>• Have access to loan records at the bank.</li> </ul>
<p><b>Wisconsin</b></p> <ul style="list-style-type: none"> <li>• Have access to loan records at the bank; review the note to confirm the interest rate reduction.</li> </ul>

**Source:** Prepared by JLARC staff using information obtained from other states.

## DUPLICATION

According to program officials of the three agencies involved, the Linked Deposit Program does not unnecessarily duplicate services offered by other state agencies and programs.

There are federal programs (for example, programs offered by the U.S. Small Business Administration) and private sector organizations (for example, community development financing institutions) that offer various types of services to small businesses and businesses owned by minorities and women. However, based on our research, we did not find evidence to show that Washington's Linked Deposit Program is unnecessarily duplicative.

## CONCLUSIONS AND RECOMMENDATION

Program officials cite lack of resources and the need for program simplicity to increase participation as the reasons for weak program controls. However, adequate controls are needed to ensure compliance with legislative intent and program requirements. Lack of program monitoring has resulted in inaccuracies in the program's database, as well as use of program by businesses without proper certification through OMWBE.

We acknowledge that implementing elaborate controls can cost a significant amount of resources and can make the program burdensome<sup>2</sup> for program participants. However, we think that the following recommendation can be implemented without incurring any significant additional costs or imposing unnecessary procedures on participants.

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<sup>2</sup> An official of one of the 19 banks interviewed said that the program involves too much paperwork. In addition, an officer of one of the four banks that did not participate in the program said that there is too much administrative effort.

***Recommendation 2***

*To ensure compliance with program requirements, the Office of the State Treasurer, the Department of Community, Trade and Economic Development, and the Office of Minority and Women's Business Enterprises should develop and implement limited procedures for monitoring the Linked Deposit Program. This should include the following:*

- Obtain from participating banks information such as minority and women's business enterprise certification status, loan amount, interest rate, loan term, purpose of the loan, and business name and address for each Linked Deposit loan recipient before the State Treasurer purchases certificates of deposit for such loans.*
- Ensure that non-certified minority and women's business enterprises do not obtain or maintain the reduced interest rate loans under the program.*

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# PROGRAM RESULTS AND EFFECTIVENESS

## Chapter Four

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### **Audit Questions:**

- *What are the results of the Linked Deposit Program since its inception?*
- *To what extent has the program been effective in meeting legislative intent to remedy the stated problem of a lack of access to capital by minority and women's business enterprises?*

**Answers:** *As reported in previous chapters, the program has enabled 230 borrowers to receive reduced interest rate loans. However, the Linked Deposit Program's effectiveness or impact cannot be measured because the program lacks performance indicators and relevant data. Performance information is largely anecdotal, which includes participants' views on the program's usefulness. Both loan recipients and banks generally commented favorably on the program.*

## IMPACT OF RATE REDUCTION

Reduction in interest rate for a loan can have an impact on the borrower's ability to service the debt (pay back loan principal plus interest). The example shown in Exhibit 7 illustrates the dollar difference made by the interest rate reduction. For a \$250,000 loan payable over five years, a borrower's monthly payment could be reduced by \$243 with a two-percentage point interest rate reduction from 10 to 8 percent. The difference in monthly income required to service the debt is \$303. This assumes a minimum debt service coverage ratio of 1.25.<sup>1</sup>

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<sup>1</sup> Debt service means regular payments of principal and interest over the term of the loan. Debt service coverage ratio is the ratio of operating income to

**Exhibit 7**  
**Example: Impact of Interest Rate Reduction**

Loan amount and term: \$250,000 for 5 years			
	<b>8% Interest</b>	<b>10% Interest</b>	<b>Monthly Difference</b>
Debt Service Per Month	\$5,069.08	\$5,311.75	\$242.67
Monthly income required for debt service coverage at ratio of 1.25	\$6,336.33	\$6,639.67	\$303.34

**Source:** Prepared by JLARC staff and consultant.

### Banks Generally Viewed the Program Favorably

Generally, bank officials commented positively on the program. However, they had mixed views on the impact of interest rate reduction in influencing banks to make the loan.

Of the 15 loans reviewed, we found one case in which it was obvious that the reduced rate influenced the decision to make the loan. In this case, the debt service ratio was bordering on the minimum ratio acceptable to the bank. In the other 14 cases, it was difficult to ascertain if the interest rate reduction had an impact on influencing loan approval because there are many factors that influence a bank's decision in approving a business loan. These factors include loan risk, credit rating, loan amount, loan term, and type of business.

One regional bank loan development officer believes the Linked Deposit Program allows the bank to develop banking relationships with minorities who would not otherwise use traditional funding sources and that this enables the bank to assist minority businesses in developing sound business practices. This included assisting them in developing programs to sell to overseas customers.

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payment required to service the debt. Banks generally require this ratio to be higher than 1.25. For example, if the monthly loan payment (principal + interest) is \$1,000, average monthly operating income should be at least \$1,250.

Several lending officers believed the program did not serve its purpose and that lending under the program would have occurred without the reduced interest rate. In the case of one larger loan, it appeared that the loan was made on a previously existing borrowing arrangement or would have been made without the program.

Several bank officials suggested that some form of credit enhancement, which reduces the risk of loss, would be more effective. We were referred to the Capital Access Programs used in many other states, including California, Oregon, and New York, in which each party involved (state, borrower, and bank) contribute a percentage of the loan toward a fund reserved for recovery of losses. There is a separate fund maintained for each bank.

## PERFORMANCE MEASURES

### Program Lacks Outcome Measures

Washington's Linked Deposit Program does not have performance measures other than how much money has been lent and some anecdotal information from borrowers and lenders that the program is useful. Program officials cited lack of resources as the main reason for this absence.

**Linked Deposit loan recipients support the program.** In order to assist us with our audit and start a database that contains feedback from program participants, the Department of Community, Trade and Economic Development (CTED) recently conducted a survey of all Linked Deposit loan recipients. The survey results provide participants' views on the program and its usefulness to them. Exhibit 8 shows responses of 80 to 83 loan recipients. Exhibit 9 lists a sample of comments of loan recipients. These comments shed some light on how the program is helping its participants.

**Exhibit 8  
Survey Responses of Linked Deposit Loan Recipients**

<b>Survey Questions</b>	<b>Percent of Respondents Said YES</b>
Did the interest rate reduction make the loan more affordable?	98% (81/83)
Did the interest rate reduction represent substantial savings for their business?	99% (80/81)
Do you feel that the Linked Deposit Program made it easier for you to obtain financing?	75% (60/80)
Would you recommend that the Linked Deposit Program be continued?	100% (83/83)

**Source:** Prepared by JLARC staff using survey responses of Linked Deposit loan recipients.

**Exhibit 9  
Examples of Loan Recipients' Comments:  
How the Program Helps Them**

<ul style="list-style-type: none"> <li>• If the program is allowed to sunset, it would impact our future equipment purchases.</li> </ul>
<ul style="list-style-type: none"> <li>• This program assisted us in obtaining additional equipment in a ramp-up situation.</li> </ul>
<ul style="list-style-type: none"> <li>• We were able to afford to build a factory specific to our production needs.</li> </ul>
<ul style="list-style-type: none"> <li>• For a small, growing business, every little bit helps. Lower interest rates have been a substantial savings for us.</li> </ul>
<ul style="list-style-type: none"> <li>• The lower interest rate reduced cash flow requirements for funding the loan. Cash is a precious commodity for all small businesses, and conserving it is a great help.</li> </ul>
<ul style="list-style-type: none"> <li>• We spend a significant percent of our budget on interest. It makes the difference between profit and loss some years.</li> </ul>
<ul style="list-style-type: none"> <li>• It helped reduce the interest paid for financing a major part of a production facility.</li> </ul>
<ul style="list-style-type: none"> <li>• Made it more affordable; help us to stay in business.</li> </ul>
<ul style="list-style-type: none"> <li>• We feel this allows a small business to be competitive.</li> </ul>

**Source:** Prepared by JLARC staff using survey responses of Linked Deposit loan recipients.

## PROGRAMS IN OTHER STATES

### Number of Jobs Created or Retained

Of the 14 states surveyed, 10 reported that they use the number of jobs created or retained as an indicator to measure their program performance. These states are Alabama, Illinois, Kentucky, Maine, Maryland, New York, Ohio, Oklahoma, Texas, and Wisconsin. Methods used to collect performance data varied by state. Examples of methods include sending questionnaires at the end of the loan term, verifying performance data at the time of loan renewal, and reviewing information in loan applications.

Four of these 10 states have also established benchmarks for their indicator, as shown in Exhibit 10. Furthermore, Illinois reviews capital investment and the type of products manufactured, and New York collects the information on the economic benefit gained by participation in the program.

**Exhibit 10**  
**Performance Benchmarks Reported by**  
**Linked Deposit Programs in Other States**

State	Key Performance Measures
Alabama	<ul style="list-style-type: none"> <li>• One job created/retained for each \$10,000 to \$15,000 borrowed.</li> </ul>
Illinois	<ul style="list-style-type: none"> <li>• One full-time permanent job created for every \$25,000 borrowed.</li> </ul>
Maine	<ul style="list-style-type: none"> <li>• One job created/retained for every \$20,000 borrowed.</li> </ul>
Ohio	<ul style="list-style-type: none"> <li>• One full-time job created/saved for every \$25,000 borrowed.</li> </ul>

**Source:** Prepared by JLARC staff using information obtained from other states.

## CONCLUSIONS AND RECOMMENDATION

The Linked Deposit Program's effectiveness or impact cannot be measured because the program lacked performance indicators and relevant data. Performance related information that the

program does have is largely anecdotal, which includes participants' views on the program's usefulness.

***Recommendation 3***

*The Department of Community, Trade and Economic Development and the Office of Minority and Women's Business Enterprises should establish modest, cost-effective, yet meaningful, indicators to measure program performance.*

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# CONTINUING PROGRAM NEED

## Chapter Five

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### **Audit Questions:**

- *Have the agencies responsible for implementing the Linked Deposit Program demonstrated the need to continue the program?*
- *Specifically, has the need identified at the inception of the Linked Deposit Program—that is, lack of access to capital among minority- and women-owned businesses—been sufficiently demonstrated to continue to exist?*
- *If the program is continued, are statutory modifications needed?*

**Answers:** *The agencies responsible for implementing the program have presented qualitative information to demonstrate the need to continue the program. We did not find statistical evidence that identifies lack of access to capital by businesses owned by minorities and women. Furthermore, due to lack of sufficient performance data, it is difficult to comment on the Linked Deposit Program’s overall effectiveness. If the program is continued, the report recommends statutory as well as other modifications relating to program controls and performance measures.*

## ASSESSMENT OF PROGRAM NEED

The literature review (see Appendix 5) supports the basic assumption behind the Linked Deposit Program. That is, in general, “minority and women’s business enterprises have been historically excluded from access to capital in the marketplace. The lack of capital has been a major barrier to the development

and expansion of business by various minority groups and women.”

In 1989, the Office of Minority and Women’s Business Enterprises (OMWBE) conducted eight hearings throughout the state.<sup>1</sup> The hearings were designed to elicit anecdotal evidence on the existence of discrimination, and the various ways in which it is practiced. According to the OMWBE director, these hearings resulted in 112 transcripts and affidavits from minority and women business owners who testified to the barriers they face in accessing capital.

These hearings are also included in the 1998 draft report of the State of Washington Disparity Study commissioned by OMWBE.<sup>2</sup> The study shows that minority and women business owners face barriers in accessing capital. According to this OMWBE director, this finding is based on anecdotal evidence. In addition to ensuring better compliance with court decisions, the disparity study is intended to be the foundation for several long-term policy decisions in the state’s minority and women’s business enterprise program.

However, we did not find sufficient statistical evidence showing that currently minority and women business owners face barriers in accessing capital in Washington State. It is important to have both anecdotal and statistical evidence in establishing systemic patterns of discriminatory exclusion from access to capital by minority and women business owners in the relevant market place; and hence, for establishing continuing program need. The importance of such evidence was conveyed in three court decisions:

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<sup>1</sup> These hearings were conducted in response to the 1989 U.S. Supreme Court ruling in *City of Richmond v. J. A. Croson Co.*, which required an increased level of documentation for the existence of government minority business enterprise programs. The case involved the city of Richmond’s Minority Business Utilization Plan (requiring at least 30 percent of the dollar amount of city contracts go to minority business enterprises). The Court ruled that strict scrutiny standard of review applies to race-based government programs. A compelling governmental interest in justifying such programs must be demonstrated and programs must be narrowly tailored to further that interest. A generalized assertion that there has been past discrimination in a particular field is not sufficient evidence.

<sup>2</sup> The disparity study was conducted by Mason Tillman Associated, Ltd.

1. City of Richmond v. J. A. Croson Co. (1989 U.S. Supreme Court decision)
2. Adarand Constructors, Inc. v. Federico Pena (1995 U.S. Supreme Court decision)<sup>3</sup>
3. Coral Construction Co. v. King County (1991 U.S. 9<sup>th</sup> Circuit Court of Appeals)<sup>4</sup>

## CONCLUSIONS AND RECOMMENDATION

It is difficult to comment on the Linked Deposit Program's overall effectiveness and its continuing need because of three reasons which are discussed in this report:

1. Absence of sufficient statistical evidence showing that minority and women business owners in Washington currently face barriers in accessing capital;
2. Lack of criteria for determining the extent to which Linked Deposit loan applicants lack access to capital; and
3. Insufficient performance data that measure program effectiveness.

However, based on the comments received from the borrowers and lenders and our analysis of loan records for a sample of

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<sup>3</sup> The case involved the U.S. Department of Transportation's practice of giving general contractors on government projects a financial incentive to hire subcontractors controlled by socially and economically disadvantaged individuals, and in particular, the government's use of race-based presumptions in identifying such individuals. The U.S. Supreme Court ruled that race-based programs must serve a compelling governmental interest and must be narrowly tailored to further that interest.

<sup>4</sup> The case involved the Minority- and Women-Owned Business Enterprise Program of Washington's King County. In this case, the Ninth Circuit Court of Appeals said "anecdotal evidence, standing alone, suffers the same flaws as statistical evidence. Indeed, anecdotal evidence may even be less probative than statistical evidence in the context of proving discriminatory patterns or practices. While anecdotal evidence may suffice to prove individual claims of discrimination, rarely, if ever, can such evidence show a systemic pattern of discrimination necessary for the adoption of an affirmative action plan." The Court further said "the combination of convincing anecdotal and statistical evidence is potent."

Linked Deposit loans, we can say that the program has made a positive difference for a number of program participants.

***Recommendation 4***

*In the absence of sufficient statistical evidence demonstrating the program's continuing need, the legislature should consider modifications discussed in Recommendations 1 through 3 if it decides to continue the Linked Deposit Program.*

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# SCOPE AND OBJECTIVES

## Appendix 1

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### SCOPE

This sunset review will analyze program information covering three biennia (1993-95, 1995-97, and 1997-99). To meet the audit deadline of June 1999, the audit objectives will be addressed to the extent necessary program data are readily available. Answers to the following four objectives will assist policymakers in deciding if the Linked Deposit Program should be continued, modified, or terminated.

### OBJECTIVES

1. **Legislative Compliance:** Have the Office of the State Treasurer, the Office of Minority and Women's Business Enterprises, and the Department of Community, Trade and Economic Development complied with legislative intent in implementing the Linked Deposit Program?
2. **Economy, Efficiency, and Duplication:** Have the implementing agencies operated the Linked Deposit Program in an efficient and economical manner? How much does the program cost the state? Does the program unnecessarily duplicate other public or private efforts? What are key characteristics of similar programs in other states?
3. **Program Results and Effectiveness:** What are the results of the Linked Deposit Program since its inception? To what extent has the program been effective in meeting legislative intent to remedy the stated problem of a lack of access to capital by minority and women's business enterprises?

4. **Continuing Program Need:** Have the agencies responsible for implementing the Linked Deposit Program demonstrated the need to continue the program? Specifically, has the need identified at the inception of the Linked Deposit Program—that is, lack of access to capital among minority- and women-owned businesses—been sufficiently demonstrated to continue to exist? If the program is continued, are statutory modifications needed?

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# **AGENCY RESPONSES**

## **Appendix 2**

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- **State of Washington Office of the Treasurer**
- **Department of Community, Trade and Economic Development**
- **Office of Minority and Women's Business Enterprises**
- **Office of Financial Management**



MICHAEL J. MURPHY  
State Treasurer

State of Washington  
Office of the Treasurer

August 12, 1999

RECEIVED

AUG 16 1999

JLARC

Rakesh Mohan  
Principal Management Auditor – JLARC  
P.O. Box 40910  
Olympia, WA 98501-2323

Dear Mr. Mohan:

Attached is a revised summary of the State Treasurer's formal response to the final sunset review report of the Linked Deposit Program as presented by the Joint Legislative Audit and Review Committee.

Sincerely,

MICHAEL J. MURPHY  
STATE TREASURER

A handwritten signature in cursive script, appearing to read "Jill M. Gravatt".

Jill M. Gravatt  
Investment Officer



08/12/99 REVISED

RE: Response to JLARC recommendations to Linked Deposit Program by The Office of the State Treasurer.

**Recommendation 1: Concur**

**COMMENTS:**

Good concept. Agencies need to be given authority to adopt regulations. Criteria needs to be identified to determine what the "maximum loan amount" should be. A study needs to be conducted to evaluate existing loan amounts.

**Recommendation 2: Concur**

**Recommendation 3: Concur**

**COMMENTS:**

More information on individual loans is needed to ensure compliance, monitoring, and collecting statistical information for performance measures on the program.

All agencies involved have an interest in developing a monitoring and performance measure mechanism. This will have an impact on staff time and resources to develop and implement a reporting system.

This information should be provided directly to each agency involved at the time the loan is considered for approval, and before money is distributed from the Treasurer to the financial institution.

The Completion date of January 2000 should be extended to June of 2000. In order for all the above recommendation to be put in place a longer time period is need to implement the changes in the program.

**Recommendation 4: Concur**



STATE OF WASHINGTON

DEPARTMENT OF COMMUNITY, TRADE AND ECONOMIC DEVELOPMENT

906 Columbia St. SW • PO Box 48300 • Olympia, Washington 98504-8300 • (360) 753-2200

August 13, 1999

RECEIVED

AUG 17 1999

JLARC

Mr. Thomas M. Sykes
Legislative Auditor
Joint Legislative Audit and Review Committee
Post Office Box 40910
Olympia, Washington 98501-2323

Dear Mr. Sykes:

Thank you for providing the Department of Community, Trade and Economic Development the opportunity to review and comment on JLARC's preliminary report of the Linked Deposit Program sunset review. The magnitude of benefit made available by the Linked Deposit Program is just beginning to unfold. A loan program made available only six years ago with no money left today is a definite statement of need. The information, positions, and comments are offered in a spirit of cooperation and partnership with the intent of strengthening the final report.

Table with 3 columns: RECOMMENDATION, AGENCY POSITION, COMMENTS. It contains two rows of recommendations regarding the Linked Deposit Program sunset review.



RECOMMENDATION	AGENCY POSITION	COMMENTS
<p>Program.</p> <ul style="list-style-type: none"> <li>• Obtain from participating banks information such as minority and women's business enterprise certification status, loan amount, interest rate, loan term, purpose of the loan, and business name and address for <u>each</u> Linked Deposit loan recipient before the State Treasurer purchases certificates of deposit for such loans.</li> <li>• Ensure that noncertified minority and women's business enterprises do not obtain or maintain the reduced rate interest loans under the program.</li> </ul>		<p>interest rates and loan terms. A comparison of this information will assist in determining the overall rate of interest charged to program participants. One important aspect CTED and/or the Treasurer's Office must keep in mind is to create a reporting system that is not burdensome and time intensive. A time intensive procedure or divulging confidential information may cause banks to withdraw from the program. Loan information will also assist CTED in determining the challenges which loan recipients face in accessing capital. <b>There is no legislative mandate to gather sensitive information. A modification of the existing tracking form can be implemented with limited time and minimal state resources.</b></p>
<p><b>Recommendation Three</b>          The Department of Community, Trade and Economic Development and the Office of Minority and Women's Business Enterprises should establish modest, cost-effective, yet meaningful, indicators to measure program performance.</p>	Partially Concur	<p>The Department agrees that the program should develop performance measures. However, there will be fiscal impact on staff time and resources to develop and implement such a system by January 2000.</p>
<p><b>Recommendation Four</b>          In the absence of sufficient statistical evidence demonstrating the programs continuing need, the legislature should consider modifications discussed in recommendations 1 through 3 if it decides to continue the Linked Deposit Program.</p>	Partially Concur	<p>Fiscal impact will occur with the development of data collection, surveys, and the implementation of on-going performance measures</p>

If you need additional information or clarification, please call Kathy Chance, Managing Director of the Business Assistance Center, at (360) 586-4848 or me at (360) 664-2007.

Sincerely,



Kathy Kreiter  
 Acting Director

cc: Kathy Chance



RECEIVED

AUG 13 1999

STATE OF WASHINGTON

OFFICE OF MINORITY AND WOMEN'S BUSINESS ENTERPRISES

406 South Water • Post Office Box 41160 • Olympia, Washington 98504-1160  
(360) 753-9693 • FAX (360) 586-7079

August 13, 1999

Mr. Thomas M. Sykes  
Legislative Auditor  
Joint Legislative Audit and Review Committee  
P.O. Box 40910  
Olympia, Washington 98501-2323

HAND DELIVER

**Re: Linked Deposit Program Sunset Review**

Dear Mr. Sykes:

Thank you for the opportunity to provide information to the Joint Legislative Audit and Review Committee (JLARC) for the sunset review of the Linked Deposit Program. In the absence of Mr. James Medina, Director, who is currently on annual leave this week, I am enclosing OMWBE's formal response to the Revised Preliminary Report. I understand this report is to be presented to JLARC at its September 15, 1999 meeting.

If you have any questions concerning OMWBE's response you may contact me directly at 360-704-1187 or Mr. Medina upon his return next week.

Sincerely,

Cathy V. Canorro, Manager  
Compliance Division

cc: James Medina, Director  
Enclosure



RECOMMENDATION	OMWBE POSITION	COMMENTS
<p><b>Recommendation 1</b></p> <p>To maximize the use of the Linked Deposit Program by a larger number of targeted business owners, we recommend that the legislature consider putting a ceiling on the maximum amount that can be borrowed by one Linked Deposit loan applicant.</p>	Partially Concur	<p>Determination of the appropriate "maximum amount" requires additional data that may be obtained via the legislative committee or agency rulemaking process, allowing stakeholder and interested party input and comment. Legislation is required to identify the agency(ies) responsible for implementation, as well as funding and authorization to adopt regulations. Currently, OMWBE does not have regulatory authority to fully implement this recommendation. OMWBE would experience fiscal impact; no funding exists in its current budget to complete by the recommended June 2000 date.</p>
<p><b>Recommendation 2</b></p> <p>To ensure compliance with program requirements, the Office of the State Treasurer, the Department of Community, Trade and Economic Development, and the Office of Minority and Women's Business Enterprises should develop and implement limited procedures for monitoring the Linked Deposit Program. This should include the following:</p> <ul style="list-style-type: none"> <li>Obtain from participating banks information such as minority and women's business enterprise certification status, loan amount, interest rate, loan term, purpose of the loan, and business name and address for each Linked Deposit loan recipient before the State Treasurer purchases certificates of deposit for such loans.</li> <li>Ensure that noncertified minority and women's business enterprises do not obtain or maintain the reduced interest rate loans under the program.</li> </ul>	Partially Concur	<p>Although CTED currently gathers some loan information, legislation is required to fully implement this recommendation. The current program does not authorize OMWBE to monitor. Legislation should include authorization for the implementing agency(ies) to adopt appropriate regulations establishing a meaningful monitoring process, along with appropriate funding. Conducting the rulemaking process will result in fiscal impact to OMWBE as it does not have funding in its current budget to implement by the recommended January 2000 date.</p>
<p><b>Recommendation 3</b></p> <p>The Department of Community, Trade and Economic Development and the Office of Minority and Women's Business Enterprises should establish modest, cost-effective, yet meaningful, indicators to measure program performance.</p>	Partially Concur	<p>Legislation is required authorizing CTED and OMWBE to adopt appropriate regulations to implement this recommendation. Legislation should also include funding to enable the agencies to conduct rulemaking in order to determine meaningful program measures and implement. OMWBE's current budget does not contain funding to implement by the recommended January 2000 completion date.</p>
<p><b>Recommendation 4</b></p> <p>In the absence of sufficient statistical evidence demonstrating the program's continuing need, the legislature should consider modifications discussed in Recommendations 1 through 3 if it decides to continue the Linked Deposit Program.</p>	Partially Concur	<p>The Linked Deposit Program should be continued for the period necessary to allow for completion of Recommendations 1 through 3. The June 2000 recommended completion date should be adjusted to account for the effective date of legislation authorizing implementation of Recommendations 1 through 3, as well as the time necessary to adopt implementing regulations and conduct necessary data gathering.</p>



STATE OF WASHINGTON  
OFFICE OF FINANCIAL MANAGEMENT  
*Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555*

September 13, 1999

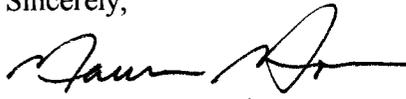
Mr. Thomas M. Sykes  
Legislative Auditor  
Joint Legislative Audit and Review Committee  
Post Office Box 40910  
Olympia, Washington 98504-0910

Dear Mr. Sykes:

RE: Response to Linked Deposit Program Sunset Review

The attached comments are offered to assist JLARC in its assessment of the Linked Deposit Program. Hopefully, our review will be of use as you prepare your final report. If you need additional information or clarification, please contact Jeff Cherry at (360) 902-0614.

Sincerely,

  
Dick Thompson  
Director

RECOMMENDATION	AGENCY POSITION	COMMENTS
<p><b>Recommendation One</b> To maximize the use of the Linked Deposit Program by a larger number of targeted business owners, we recommend that the legislature consider putting a ceiling on the maximum amount that can be borrowed by a Linked Deposit loan applicant.</p>	Partially Concur	The Office of Financial Management concurs with the recommendation. However, further evaluation is necessary to determine the amount of the ceiling and the impact of a ceiling on the participants of the program. Information will also help determine if a ceiling will effectively increase the number of participants in the program, or potentially impose a barrier on the borrowers and the lending institutions working with those borrowers.
<p><b>Recommendation Two</b> To ensure compliance with program requirements, the Office of the State Treasurer, the Department of Community, Trade, and Economic Development, and the Office of Minority and Women Business Enterprises should develop and implement limited procedures for monitoring the Linked Deposit Program. This should include the following:</p> <ul style="list-style-type: none"> <li>• Obtaining from participating banks information such as minority and women's business enterprise certification status, loan amount, interest rate, loan terms, purpose of the loan, and business name and address for each Linked Deposit loan recipient before the State Treasurer purchases certificates of deposit for such loans.</li> <li>• Ensure that non-certified minority and women's business enterprises do not obtain or maintain the reduced interest rate loans under the program.</li> </ul>	Partially Concur	The development of stronger monitoring and program controls is necessary to ensure that the program is effective and efficient. Additional information is necessary concerning the costs associated with the development of adequate program controls and the cost-benefit of each control measure. Legislation may also be required in order to obtain information from lending institutions about the specifics of each loan. Because lending institutions volunteer to participate in the program, there should be further discussion about how to best elicit information and establish monitoring controls that do not deter lenders from participating.
<p><b>Recommendation Three</b> The department of Community, Trade, and Economic Development and the Office of Women and Minority Business Enterprises should establish modest, cost-effective, yet meaningful, indicators to measure program performance.</p>	Partially Concur	The implementation of performance measures in the Linked Deposit Program is in keeping with our efforts to improve state government and the effectiveness of state programs. The development of the appropriate performance measures should coincide with the establishment of stronger program controls. It may be difficult for the agencies involved to coordinate and implement the recommended changes by January 2000. The rapid turnaround period could also increase the fiscal impact.
<p><b>Recommendation Four</b> In the absence of sufficient statistical evidence demonstrating the program's continuing need, the legislature should consider modifications discussed in Recommendations 1 through 3 if it decides to continue the Linked Deposit Program.</p>	Partially Concur	We agree that further data should be gathered to better assess the value of the program, however the June 2000 completion date may not allow enough time to implement the recommendations suggested in the report.

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# AUDIT METHODOLOGY AND LIMITATIONS

## Appendix 3

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### BACKGROUND RESEARCH AND STAKEHOLDER INPUT

As part of this audit, we reviewed the literature, researched relevant Washington State legal and budget documents, and reviewed agency documents relating to the program. In developing our audit scope and objectives, we interviewed legislative staff, officials of the three state agencies responsible for implementing the program, and various stakeholders, including the U.S. Bank, Cascadia Revolving Fund, and the Millenium Fund of Seattle.

We consulted with officials of the Department of Financial Institutions and the University of Washington Business and Economic Development Program. We also discussed the audit approach of evaluating the program's economic impact with two economists from the University of Washington and the Evergreen State College.

### COST ANALYSIS

We asked the officials of the State Treasurer's Office to describe the investment policy used by the State Treasurer and to provide us with necessary assumptions that can be used in estimating the cost of the Linked Deposit Program since its inception. Following is a brief description of the information we obtained from the Office of the State Treasurer.

#### State Treasury's Investment Policy

Safety, liquidity, and yield are the traditional priorities of treasury investment management. These priorities are incorporated into a single overall objective of the State Treasurer's investment policy. The objective is to construct investment

portfolios that are optimal. The treasury investments are separated into three portfolios, primarily to manage liquidity risk:

1. **Liquid Asset Portfolio.** The objective of this portfolio is to meet the liquidity needs of the treasury. All daily cash requirements are to be met by assets in this portfolio. It has an expected risk objective of zero liquidity risk. Consistent with that risk objective, it has a benchmark of the targeted Fed Funds Rate, which is a readily available proxy for the risk-free rate. The targeted Fed Funds Rate is set by the Federal Open Market Committee. The average rate of return on this portfolio is the targeted Fed Funds Rate plus 10 basis points. The average life of these investments is generally less than 30 days.
2. **Intermediate Portfolio.** This portfolio is established as a hedge against unanticipated large changes in projected cash flows. The average rate of return on this portfolio is the targeted Fed Funds Rate plus 30 basis points. The maximum average life of these investments is 270 days.
3. **Core Portfolio.** This portfolio is comprised of funds not expected to be utilized over a 1-2 year horizon. This portfolio contains longer maturity securities and generally has an average life between 2-2.5 years. The average rate of return on this portfolio is the targeted Fed Funds Rate plus 100 basis points.

## Key Assumptions

Since the investment climate changes from month to month, it is difficult to generalize the returns of the three portfolios in the treasury. Rates go up and then down again. A cycle may take a few years to complete, and no cycle is the same as another. If one takes a six-month or one-year snapshot of portfolio returns, it may be a long way from that 100 basis points. The same can be said for the spread between the targeted Fed Funds Rate and the inflation rate.

Recognizing the preceding caveat, the following assumptions were used in calculating the cost of the interest rate reduction under the Linked Deposit Program:

- The average inflation from 1994 through 1999 is 2.4 percent.
- The Liquid Asset Portfolio earns 2.00 percent over the inflation.
- The weighted total balance of the State Treasury's funds earns an estimated 70 basis points (0.70 percent) over the targeted Fed Funds Rate.

- The Core Portfolio earns 2.45 percent over the funds in the Linked Deposit Program.
- The Core Portfolio earns 0.54 percent over the funds in the Certificate of Deposit Program.<sup>1</sup>
- Because currently there is not enough demand for the funds available through the Certificate of Deposit Program,<sup>2</sup> we used the rate for the Core Portfolio as the rate that would be earned by the funds if the Linked Deposit Program had not existed.
- We used the Linked Deposit Program's average outstanding balance for each year (sum of outstanding monthly balances divided by number of months) since the program's inception (from June 1994 through February 1999).

## Calculations

Using the assumption listed above, we calculated that the total cost of the two-percentage points reduction in interest rate for Linked Deposit loan recipients is \$3,806,138 (adjusted for inflation) in forgone interest on state deposits.

<b>Year</b>	<b>Average Outstanding Balance</b>	<b>Subsidy/Cost (Balance x 2.45%)</b>	<b>Adjusted for Inflation in 1999 Dollars</b>
1994	\$1,113,674	\$27,285	\$32,387
1995	8,930,243	218,791	250,516
1996	19,572,148	479,518	527,469
1997	30,386,094	744,459	792,105
1998	40,257,118	986,299	1,023,779
1999	48,158,443	1,179,882	1,179,882
<b>Total State Subsidy (Cost)</b>		<b>\$3,636,234</b>	<b>\$3,806,138</b>

Source: JLARC calculations based on data from the Office of the State Treasurer.

<sup>1</sup> The Linked Deposit Program is a subset of the Certificate of Deposit Program (RCW 43.86A.030). The amount of funds available in the Certificate of Deposit Program is calculated based on a formula described in the program's authorizing legislation. As of March 1999, the total amount of funds in the Certificate of Deposit Program is \$380 million. A total of \$50 million of these funds is earmarked for the Linked Deposit Program.

<sup>2</sup> Excluding Linked Deposit funds, the remaining Certificate of Deposit Program has a total of \$330 million. Only about 25 percent of the \$330 million are currently being used by the participating financial institutions.

## **SURVEY OF LINKED DEPOSIT LOAN RECIPIENTS**

To provide us with information on program results, the Department of Community, Trade and Economic Development (CTED) conducted a survey of all Linked Deposit loan recipients who have participated in the program as of December 1998. CTED staff was responsible for mailing the questionnaire to the loan recipients and receiving their responses. They forwarded copies of those responses to us for analysis. JLARC staff assisted CTED with transferring the responses to a computer database.

Although CTED conducted the survey of loan recipients, the analysis of survey responses contained in this report was done by JLARC staff. When necessary, JLARC and CTED staff followed up with the respondents. A copy of the questionnaire used in the survey is included in Appendix 4.

The questionnaire was sent to all 213 certified minority and women's business enterprises that participated in the Linked Deposit Program as of December 1998. The response rate was 44.1 percent. Because of the way questionnaires were completed, not all survey responses were used for analysis.

## **REVIEW OF LINKED DEPOSIT LOANS AND INTERVIEWS WITH LENDERS**

JLARC contracted with Pacific Consulting Group, Inc. to review and analyze Linked Deposit loan information. The focus of the consulting group's review with banks was to evaluate the effectiveness and impact of the Linked Deposit Program and whether the program should be continued.

To conduct this part of the sunset review, the consulting group contacted all 20 banks (which were participating as of February 1999) to arrange interviews with appropriate bank officers and to arrange more detailed reviews of selected loans for selected banks. The consulting group interviewed, in person or by phone, bank officials responsible for key functions relating to the program for 19 of the 20 banks (one bank did not respond to requests for interview).

For those banks visited and/or interviewed, the consulting group looked for the following information:

- Any discrepancies in the information provided under the program as compared to information in the files
- Reasons for their participation in the program

- Effectiveness of program in improving access to capital by minority- and women-owned businesses
- Processes used by the banks in implementing the program, including answers to the following questions:
  - > What criteria are used in approving the loan?
  - > How is borrower verified as being certified under the program?
  - > What happens if business is later decertified before the loan is paid off?
  - > What out-reach efforts (if any) are used to promote the Linked Deposit Program?

The consulting group in consultation with JLARC staff selected five banks believed to represent a cross section of banks participating in the program. For those selected banks:

- Based on review of summary loan information, selected 15 loans to review in detail. For the selected loans:
  - > Reviewed directly or through bank officer the borrower's credit files for the loans.
  - > Reviewed pricing of loans for reasonableness in relation to information available in credit files and level of interest rates when underwriting the loan.
- Based on review of summary information provided by the selected banks and survey results received from borrowers, investigated apparent or possible discrepancies relating to borrower qualifications or the interest rate charged to program participants.

Finally, the consulting group contacted eight banks that did not participate in the program. We received feedback from four as to their reasons for non-participation.

## Limitations on Scope of Work

Because of the nature of the lending processes and the organizational structure and record-keeping procedures used by various banks, it was often not possible to directly review all credit documents for loans selected for detailed review. In many cases, principally for the larger banks, credit files are maintained at remote sites, and the individuals coordinating and maintaining records for the program are not located at the lending offices where the loans are made. In addition, we do not have express authority to examine bank customer files.

Therefore, in many cases, detailed information related to loan files was obtained indirectly using the banks' program coordinators or lending officers. However, based on our discussions with bank officers providing us information, and on the material provided to us, we have no reason to believe that the information we received did not accurately reflect the underlying loan records.

The broad array of banks involved in the program can have significantly different types of target markets and customers, and borrowers under the program can reflect varying levels of risk depending on the predictability of the business, liquidity, leverage, financial strength of guarantors, term of loan, and other factors. In addition, banks tend to have varying methods of pricing loans based on these factors. Therefore, evaluating compliance in passing on the reduced rate in many cases can be very judgmental, although in some cases it was obvious the reduced rate was fully passed on to the borrowers.

Finally, to maintain confidentiality of loan records, names of borrowers and lenders are not disclosed in this report.

## SURVEY OF OTHER STATES

We used the following sources to identify other states that have programs similar to Washington's Linked Deposit Program:

- Officials of the three Washington agencies—the Department of Community, Trade and Economic Development, the Office of Minority and Women's Business Enterprises, and the Office of the State Treasurer
- Woodstock Institute<sup>3</sup> publications and website (<http://online.nonprofit.net/woodstock/>)
- National Association of State Development Agencies' (NASDA) Directory of Incentives, March 22, 1999
- National Conference of State Legislatures (NCSL)
- Internet search

The scope of the research for other states was limited to those states with programs that target small businesses and/or minority- and women-owned businesses. As a result, we identified 14 states that have programs similar to Washington's Linked

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<sup>3</sup> Woodstock Institute is a Chicago-based nonprofit organization, that works locally and nationally to promote community reinvestment and economic development in lower-income and minority communities. In July 1991, the Institute reported results of a nationwide survey of linked deposit programs at state and local levels.

Deposit Program. These states and their agencies implementing the linked deposit program are:

Alabama	Office of State Treasurer
Illinois	Office of State Treasurer
Iowa	Office of State Treasurer
Kentucky	Cabinet for Economic Development
Louisiana	Office of State Treasurer; Department of Economic Development
Maine	Finance Authority of Maine
Maryland	Department of Business and Economic Development
Missouri	Office of State Treasurer
New York	Empire State Development
Ohio	Office of State Treasurer
Oklahoma	Office of State Treasurer
Pennsylvania	Office of State Treasurer (Note: The program is called Small Business Development Program.)
Texas	Department of Economic Development
Wisconsin	Wisconsin Housing and Economic Development Authority

We contacted these states for the information about their linked deposit programs. Our questions to officials of these states focused primarily on three areas: program description, monitoring and oversight, and performance measures. In addition to contacting program officials of these states, we used information from their websites, NCSL website ([www.ncsl.org/programs/econ/linked.htm](http://www.ncsl.org/programs/econ/linked.htm)), and NASDA Directory of Incentives. Because we did not audit the information provided by the surveyed states, such information should be used with care.

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# QUESTIONNAIRE FOR SURVEY OF LINKED DEPOSIT LOAN RECIPIENTS

Appendix 4

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**WASHINGTON STATE LINKED DEPOSIT PROGRAM**

**SURVEY**

**March 26, 1999<sup>1</sup>**

1. Did your business *receive* a Linked Deposit loan? Yes\_\_\_ No\_\_\_  
Business Name:\_\_\_\_\_ Phone\_\_\_\_\_
- Was this a *new* loan? Yes\_\_\_ No\_\_\_
- Was the loan made to *refinance* an existing loan? Yes\_\_\_ No\_\_\_
- Was this a line of credit? Yes\_\_\_ No\_\_\_
- What is the rate of interest on the loan? \_\_\_\_\_
2. Did your *bank recommend* the Linked Deposit loan? Yes\_\_\_ No\_\_\_
3. Was the Linked Deposit loan made at *your request*? Yes\_\_\_ No\_\_\_
4. Did the 2% interest rate reduction make the loan more affordable for your businesses?  
Yes\_\_\_ No\_\_\_ Explain\_\_\_\_\_
5. Did this *reduction* in interest rate represent substantial savings to your business?  
Yes\_\_\_ No\_\_\_
6. Do you feel that the Linked Deposit Program made it *easier* for you to obtain financing?  
Yes\_\_\_ No\_\_\_ Explain\_\_\_\_\_
7. Did you obtain *certification* with the Office of Minority and Women's Business Enterprises specifically to obtain a Linked Deposit Loan? Yes\_\_\_ No\_\_\_
8. Would you recommend that the Linked Deposit Program be *continued*? Yes\_\_\_ No\_\_\_
9. If we have additional questions, may we contact you? Yes\_\_\_ No\_\_\_

Additional Comments: \_\_\_\_\_

Please return this survey by **FAX to: Judy Putnam, 206-956-3160** or return in the enclosed envelope.

Judy Putnam  
Washington State Dept. of Community,  
Trade and Economic Development  
2001 6<sup>th</sup> Ave. Suite 2600  
Seattle, WA 98121  
Phone: 206-956-3164 e-mail judyp@cted.wa.gov

<sup>1</sup> The questionnaire was sent on this date to certified minority-owned businesses. It was sent to certified women-owned businesses on June 1, 1999.

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